90-441

No. ____

In the

Supreme Court of the United States

October Term, 1990

IN RE: NWFX, Inc.,
PYBURN ENTERPRISES, INC. ..... *Petitioner*

V.

ALLEN W. BIRD, II
AS TRUSTEE FOR NORTHWEST
FINANCIAL EXPRESS, INC., NWFX, INC.,
AND GOLD FINANCIAL
EXPRESS, INC. ..... *Respondents*

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION
FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Is a contract between debtor, a seller of money orders, and its agent, governed by Texas law, where the agreement was executed and performed in Texas and where Texas had a substantial interest in protecting its citizens; or is it governed by Arkansas law, where the debtor is an Arkansas corporation and filed for bankruptcy protection in the state of Arkansas?

2. Did the debtor breach its agency contract when it became insolvent and filed a bankruptcy, resulting in the dishonor of its money orders nationwide?

3. Were refunds made by the agent to purchasers of the debtor's dishonored money orders, property of the debtor's estate, and subject to turnover to the bankruptcy trustee?

4. Should prejudgment interest be assessed against the debtor's agent as a matter of law when to do so would be inequitable?

LIST OF ALL PARTIES

All parties appear in the caption of the case in the Court.

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No. ____

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OPINIONS BELOW

The opinion of The United States Court of Appeals for the Eighth Circuit sitting en banc, is reported as follows: *In re NWFX, Inc.*, 904 F.2d 469 (8th Cir. 1990), and is printed in the Appendix hereto, infra, page A-1. The judgment of The United States Court of Appeals for the Eighth Circuit is printed in the Appendix hereto, infra, page A-50. The prior opinion of the United States Court of Appeals for the Eighth Circuit, also reprinted in the Appendix, infra, page

A-3, is reported as follows: *In re NWFX, Inc.*, 881 F.2d 530 (8th Cir. 1989). The opinion of The United States Court of Appeals for the Eighth Circuit in two companion cases, also reprinted in the Appendix, infra, A-31 and A-40, are reported as follows: *In re NWFX, Inc.*, 864 F.2d 593 (8th Cir. 1989), and *In re NWFX, Inc.*, 864 F.2d 588 (8th Cir. 1988), respectively.

JURISDICTION

The judgment of The United States Eighth Circuit Court of Appeals was entered on June 11, 1990. The jurisdiction of the Supreme Court is invoked under 28 U.S.C. §1254 (1).

STATUTES INVOLVED

Title 11 of The United States Code §§105 and 541 are set out verbatim in the Appendix hereto, infra, page A-53.

STATEMENT OF THE CASE

NWFX, Inc., was an Arkansas corporation in the business of selling money orders nationwide. It filed voluntary chapter 11 proceedings on August 1, 1986. Immediately NWFX, Inc., as debtor-in-possession, filed an adversary proceeding in bankruptcy Court seeking turnover of monies, money orders and supplies held by various enterprises acting as agents selling its money orders. Pyburn Enterprises Inc., a corporation consisting of four grocery stores located in Houston, Texas, was also named as a defendant in one of those lawsuits.

Prior to the bankruptcy filing, Pyburn sold NWFX, Inc. money orders, collected proceeds, and on a weekly basis was required to prepare settlement reports and remit directly to NWFX all funds held in trust plus twenty-two (22) cents per money order sold. On or about July 25, 1986 the bank through which these money orders cleared ceased its relationship with NWFX, Inc. and closed its account. NWFX, Inc. then discontinued its operations.

This bankruptcy had a devastating effect on tens of thousands of Texas citizens who had purchased the company's money orders. Because of the tremendous impact this bankruptcy had on lower income citizens, Jim Mattox, Attorney General for the State of Texas, asked retail store owners to refund their customers' money for dishonored NWFX money orders. In response to this humanitarian plea, Pyburn made refunds to its customers, who held dishonored money orders, totaling $70,600.62.

Allen W. Bird, II was appointed Trustee for NWFX Inc., and amended the adversary proceeding by filing an amended complaint on August 28, 1987, alleging breach of contract by Pyburn. In the amended complaint the Trustee sought damages for breach, along with interest at the rate of 10% per annum from August 1, 1986. Trial was conducted on April 26, 1988 before the Honorable Robert F. Fussell,

Bankruptcy Judge for the Western District of Arkansas. After trial the Bankruptcy Court submitted proposed findings of fact and conclusions of law recommended for adoption by the United States District Court regarding the breach of contract claim and the entitlement to prejudgment interest.

The Honorable H. Franklin Waters adopted *in toto* the findings and recommendations of the Bankruptcy Court and entered judgment against Pyburn Enterprises, Inc. for breach of contract in the amount of $70,600.62, plus prejudgment interest, in an Order dated June 29, 1988, in the United States District Court, Western District of Arkansas, Fayetteville Division.

A Notice of Appeal to the United States Court of Appeals for the Eighth Circuit was filed August 30, 1988 by Pyburn Enterprises, Inc. seeking review of the final order of the District Court, pursuant to 28 U.S.C. § 1291.

After hearing oral arguments, a three judge panel of The United States Court of Appeals for the Eighth Circuit reversed and concluded that the proceeds from the sale of NWFX, Inc. money orders, which were refunded to purchasers of dishonored money orders, were not subject to turnover to NWFX's bankruptcy estate. This opinion is dated August 1, 1989. In so doing the Court addressed what it decided was an apparent conflict between two similar cases in the Eighth Circuit involving the same bankruptcy.

In *In Re: NWFX, Inc.*, 864 F.2d 588 (8th Cir. 1988), the Court did not require the money order sellers to turn over the amount of the refunds made to money order purchasers, while in *In Re: NWFX, Inc.*, 864 F.2d 593 (8th Cir. 1989), the Court did require the turnover of refunds. The panel concluded that the reasoning in the first case should be employed to resolve Pyburn's case. Refunds to purchasers of money orders under the circumstances of Pyburn's case were not property of the bankruptcy estate.

A rehearing en banc was granted on motion by the Trustee and the panel opinion was vacated.[1] After hearing oral arguments the judgment of the District Court was affirmed by an equally divided Court, in an opinion filed June 11, 1990, per curiam.[2] Pyburn Enterprises, Inc. now petitions the Court to review this decision and address the issues raised by the vacated panel opinion.

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[1] *In re NWFX, Inc.*, 881 F.2d 530 (8th Cir. 1989).

[2] *In re NWFX, Inc.*, 904 F.2d 469 (8th Cir. 1990).

REASONS FOR GRANTING WRIT

I.

THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT LEAVES UNRESOLVED CONFLICTING PANEL OPINIONS WITHIN THAT CIRCUIT WHICH SHOULD BE RESOLVED BY THIS COURT.

Two conflicting opinions of the United States Court of Appeals for the Eighth Circuit, which are companion cases to the present case, remain unresolved. These cases are referred to as *In re NWFX, Inc.*, 864 F.2d 588 (8th Cir. 1988) [hereinafter *NWFX I*] and *In re NWFX, Inc.*, 864 F.2d 593 (8th Cir. 1989) [hereinafter *NWFX II*]. Both opinions were rendered prior to the date appeal was taken to the United States Court of Appeals for the Eighth Circuit in this case. Moreover, the two conflicting opinions also involved the same bankruptcy under similar circumstances as the present case.

In *NWFX I*, the Court held that although the grocery store chain was selling debtor's money orders, no actual agreement existed for the sale of debtor's non-insured money orders because of a dispute between the parties over signing a new contract prior to the bankruptcy being filed. Nevertheless the Court held that the grocery store chain would be unjustly enriched if it were allowed to retain all proceeds of those money orders; thus, an equitable interest equal to the reasonable value of excess benefits that the chain received from its dealings with the debtor constituted property of the estate and as such was subject to turnover. On the issue of refunded proceeds, the Court stated that no basis appeared on which such proceeds could be turned over. The panel reasoned that because the grocery store chain did not retain the proceeds, it could not be said to have been unjustly enriched. *NWFX I* at 591.

In *NWFX II*, a different panel, without the issue of a disputed contract, held that a grocery store chain, as selling agent for debtor's money orders, was required to turnover to the bankruptcy estate, the amount of money it refunded to purchasers of debtor's dishonored money orders. The Court further stated that creditors were not entitled to any equitable setoff, nor to use the doctrine of recoupment or to retain money refunded as an exception to the general rule of turnover. The Court stated that the agent's agreement with the debtor provided that the agent would hold in trust any funds received on behalf of the debtor and therefore any refund could not have been made in good faith. *NWFX II* at 596.

Pyburn Enterprises, Inc., argued on appeal that these two cases were in conflict. A panel of judges for the United States Court of Appeals for the Eighth Circuit agreed in an opinion dated April 12, 1989. In that opinion the Court stated that there are no significant factual differences which would justify the different conclusions reached in these two cases. The Court concluded that the reasoning in *NWFX I* should be employed to resolve the case before them. The Court held that the proceeds from the sale of NWFX money orders which were refunded by Pyburn Enterprises to purchasers of dishonored money orders were not subject to turnover to NWFX's bankruptcy estate. See: *In re NWFX, Inc.*, 881 F.2d 530 (8th Cir. 1989).

The petitioner submits that the United States Court of Appeals for the Eighth Circuit has erred by affirming the District Court decision and vacating the previous panel decision in this case. The opinion does not resolve the above conflict and leaves unanswered important issues encountered by bankruptcy practitioners. In addition, state officials are left with no guidance as to what advice to give the general public if such a situation occurs in the future. These questions should be resolved by this Court.

II.

THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT LEAVES UNANSWERED IMPORTANT QUESTIONS OF FEDERAL BANKRUPTCY LAW WHICH SHOULD BE SETTLED BY THIS COURT.

Petitioner submits that the United States Court of Appeals for the Eighth Circuit erred when it affirmed the District Court in the present case, thus vacating its previous panel decision. The opinion dated June 11, 1990, merely states that after rehearing en banc, the judgment of the District Court is now affirmed by an equally divided Court. See: *In re NWFX, Inc.*, 904 F.2d 469 (8th Cir. 1990).

The vacated panel opinion dated August 1, 1989, raised the following important and unsettled questions of federal law. Is a contract between debtor, a seller of money orders, and its agent, governed by Texas law, where the agreement was executed and performed in Texas and where Texas had a substantial interest in protecting its citizens; or it is governed by Arkansas law, where the debtor is an Arkansas Corporation and filed for bankruptcy protection in the State of Arkansas? Did the debtor breach its agency contract when it became insolvent and filed for bankruptcy, resulting in the dishonor of its money orders nationwide? Were refunds made by the agent to the purchasers of the debtor's dishonored money orders, property of the debtor's estate, and subject to turnover to the bankruptcy trustee? Should prejudgment interest be assessed against the debtor's agent as a matter of law when to do so would be inequitable? See: *In re NWFX, Inc.*, 881 F.2d 530 (8th Cir. 1989).

The panel found that Texas law governed in this case because of the substantial interest of the State of Texas. The Court also held that the debtor breached its contract with its agent when it became insolvent and filed for

bankruptcy, thereby causing the dishonor of its money orders and harm to its agents' reputation and goodwill. The debtor also breached its implied covenant of good faith, inherent in its contract, in selling the money orders to the public, when these orders were dishonored due to Debtor becoming insolvent and filing for bankruptcy. Also selling money orders to the public would be void against public policy if it were interpreted to allow debtors to issue money orders without a corresponding obligation to honor them. This material breach by the debtor entitled the agent to take all actions necessary to minimize adverse consequences, including making refunds to purchasers of the dishonored money orders. Consequently, refunds to money order purchasers were not property of the debtor's estate and therefore not subject to turnover.[1]

These conclusions are consistent with previous decisions of this Court. It has been said that there is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction. *Bank of Marin v. England*, 385 U.S. (1966).[2] "The Trustee succeeds only to such rights as the bankrupt possessed; and the Trustee is subject to all claims and defenses which might have been asserted against the bankrupt before the filing of the petition." *Marin* at 101. "But the bankruptcy rule is that he [the Trustee] takes the contract of the debtors subject to their terms and conditions. Contracts adopted by him are assumed cum onere." *Thompson et al. v. Texas American Railroad Company*, 328 U.S. 134, 142 (1946).

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[1]Property of the bankruptcy estate is defined at 11 USC §541, which is set out verbatim in the appendix hereto, infra, page A-53.

[2]The bankruptcy Court's equitable powers are described at 11 USC §105, which is set out verbatim in the appendix hereto, infra, page A-53.

CONCLUSION

This Court should review this case because it involves a matter of substantial public importance and concern, as evidenced by the amicus curiae brief filed by the State of Texas in support of Pyburn's legal arguments in the United States Court of Appeals for the Eighth Circuit. For these reasons, it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

/s/ Mark A. Colbert

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Little Rock, AR 72203-1300
Telephone (501) 374-9977

September 10, 1990

CERTIFICATE OF SERVICE

I, Mark A. Colbert, do hereby certify that the above and foregoing has been mailed by ordinary mail with sufficient postage affixed thereon, on this the 7th day of September, 1990, to:

United States Court of Appeals
For the Eighth Circuit
U.S. Court & Customs House
1114 Market Street
St. Louis, Missouri 63101

The Honorable H. Franklin Waters
United States District Court
Federal Building
Fayetteville, AR 72701

The Honorable Robert F. Fussell
U.S. Bankruptcy Court
P.O. Box 2381
Little Rock, AR 72203-2381

Allen W. Bird, II, Esq.
120 E. Fourth Street
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Ms. Caroline Scott
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/s/ Mark A. Colbert
MARK A. COLBERT

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT
Western Dist. Arkansas
(Filed June 14, 1990)

No. 88-2395

In re: NWFX, Inc., (Consolidated)	*	
Debtor,	*	
Allen W. Bird, II, as Trustee for Northwest Financial Express, Inc., NWFX, Inc., and Gold Financial Express, Inc.,	*	Appeal from the United States District Court for the Western District of Arkansas
Appellee,	*	[PUBLISHED]
v.	*	
Crown Convenience, Derby Refining, et al., (Pyburn Enterprises, Inc.),	*	
Appellant.	*	

Submitted: January 19, 1990
Filed: June 11, 1990

Before LAY, Chief Judge, FLOYD R. GIBSON, Senior Circuit Judge, McMILLIAN, ARNOLD, JOHN R. GIBSON, FAGG, BOWMAN, WOLLMAN, MAGILL, and BEAM, Circuit Judges, en banc.

PER CURIAM.

In this matter, a panel of this court reversed the judgment of the district court. *In re NWFX, Inc.*, 881 F.2d 530 (8th Cir.

1989). The suggestion for rehearing en banc was granted, thus vacating the panel opinion. After rehearing en banc, the judgment of the district court is now affirmed by an equally divided court. Chief Judge Lay and Judges McMillian, Arnold, Wollman, and Magill vote to affirm the district court. Judges Floyd R. Gibson, John R. Gibson, Fagg, Bowman, and Beam would reverse. The clerk of the court is directed to issue the mandate forthwith.

A true copy.

Attest:

/s/ Robert D. St. Vrain
CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 88-2395

In re: NWFX, Inc., (Consolidated)	*	
Debtor,	*	
Allen W. Bird, II, as Trustee for Northwest Financial Express, Inc., NWFX, Inc., and Gold Financial Express, Inc.,	*	Appeal from the United States District Court for the Western District of Arkansas
Appellee,	*	
v.	*	
Crown Convenience, Derby Refining, et al., (Pyburn Enterprises, Inc.),	*	
Appellant.	*	

Submitted: April 12, 1989

Filed: August 1, 1989

Before FAGG, Circuit Judge, FLOYD R. GIBSON and TIMBERS*, Senior Circuit Judges.

FLOYD R. GIBSON, Senior Circuit Judge.

*The HONORABLE WILLIAM H. TIMBERS, Senior United States Circuit Judge for the Second Circuit Court of Appeals, sitting by designation.

Pyburn Enterprises, Inc. (Pyburn) appeals an order of the district court entered pursuant to the proposed findings of fact and conclusions of law submitted by the bankruptcy court which found Pyburn had breached its contract with Northwest Financial Express, Inc. (NWFX) involving the sale of money orders. For the reasons that follow we reverse the order of the district court.

I. BACKGROUND

This case arose after NWFX filed a voluntary chapter 11 bankruptcy petition on August 1, 1986. NWFX is an Arkansas corporation that was engaged in the business of selling money orders nationwide. As a result of its bankruptcy, several cases similar to the present case have been filed. *See, e.g., In re NWFX, Inc.*, 864 F.2d 588 (8th Cir. 1988) [hereinafter *NWFX I*] and *In re NWFX, Inc.*, 864 F.2d 593 (8th Cir. 1989) [hereinafter *NWFX II*].

NWFX sold its money orders through grocery stores and other retail outlets that acted as its agent. NWFX's arrangement with its agents provided that the stores would sell NWFX money orders to their customers and remit the proceeds from the sales directly to NWFX. Pyburn was one of the grocery store chains selling NWFX money orders. Pyburn has four grocery stores located in Houston, Texas. The arrangement between Pyburn and NWFX, labeled a "Trust Agreement," provided that Pyburn would act as NWFX's agent and sell its money orders.

Pyburn was to hold all moneys received from the sale of NWFX money orders in trust for NWFX and on a weekly basis Pyburn was required to prepare a settlement report and remit to NWFX all funds held in trust plus 22 cents per money order sold. In return for selling NWFX's money orders Pyburn was entitled to retain a portion of the fee which was charged to the money order purchaser.

On July 25, 1986, the bank through which the NWFX money orders cleared closed NWFX's account and ceased

its relationship with NWFX. Upon learning of this, Pyburn became concerned. Rather than remit the proceeds from the sale of money orders to NWFX, Pyburn retained $89,052.88 of the proceeds from the money order sales.

NWFX's bankruptcy had a devastating effect on thousands of Texas citizens who purchased NWFX money orders. Most of the money orders were purchased by people with low incomes. The money orders were often purchased to pay bills such as rent and utility expenses. Accordingly, when NWFX money orders were dishonored money order purchasers faced dire consequences. Mr. Pyburn, the owner of Pyburn Enterprises, explained that

> [M]ost of the people that buy money orders are people that don't have bank accounts. They are people that live from week to week, and they don't have much money, and they cash their paycheck. They have real dollars in their hand, and they exchange those real dollars for a safe form of money to pay their bills with so they'll have receipts.

(Tr. 30-32) Because of the tremendous impact NWFX's bankruptcy had on Texas' lower income citizens, Jim Mattox, Attorney General for the State of Texas,[1] made a humanitarian plea to retail store owners engaged in selling NWFX money orders to refund moneys obtained from purchasers of the dishonored NWFX money orders.[2] In

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[1]The State of Texas filed an amicus curiae brief in support of Pyburn's legal arguments.

[2]In a newspaper article appearing in the Houston Chronicle it was reported:

> State Attorney General Jim Mattox is urging supermarkets and other stores that sold money orders from a failed Arkansas company to make refunds.
>
> When Northwest Financial Express filed for bankruptcy last week, it left Texas consumers holding between $5 million and $6 million in worthless money orders in "one of the most widespread consumer rip-offs we've seen in Texas in a long time," said Mattox.

Hous. Chron., Aug. 14, 1986, § 2, at 1, col. 3.

response to this plea Pyburn made refunds to its money order customers totalling $70,600.62. Pyburn prepared a release which its customers were required to sign when they received their refund.

On August 1, 1986, NWFX filed its bankruptcy petition and on that same day it, as debtor-in-possession, filed an adversary proceeding seeking the turnover of moneys, money orders, and supplies held by the retailers that sold its money orders. A trustee for NWFX's bankruptcy estate was appointed by the bankruptcy court. The trustee amended the adversary proceeding by alleging a breach of contract by Pyburn. The trustee sought damages for Pyburn's alleged breach of contract and prejudgment interest at the rate of 10% per annum. A trial was held before the bankruptcy court which then made recommended findings of fact and conclusions of law.

The bankruptcy court recommended to the district court that judgment be entered in NWFX's favor. Specifically the court concluded that Pyburn breached the contract with NWFX and NWFX's damages totalled $89,052.28 (the amount withheld by Pyburn). The $89,052.28 was reduced to $70,600.62 because Pyburn tendered $18,451.66 at trial. The amount tendered at trial represented the funds remaining after Pyburn refunded $70,600.62 to its customers. The bankruptcy court also recommended an award of prejudgment interest at the rate of 6% per annum. The district court adopted the bankruptcy court's recommendations in toto. This appeal followed. We reverse.

II. DISCUSSION

A. Jurisdiction

The first argument raised by Pyburn challenges the bankruptcy court's jurisdiction to hear this dispute. This assertion does not warrant extended discussion. The

bankruptcy court concluded that it had jurisdiction over the complaint pursuant to 28 U.S.C. § 157 (c) (1).[3] In *In re Dogpatch U.S.A., Inc.*, 810 F.2d 782, 786 (8th Cir. 1987), this court held that "[f]or a proceeding to be 'related to' a bankruptcy case for purposes of bankruptcy jurisdiction, courts require that it 'have some effect on the administration of the debtor's estate.' " (quoting *Zweygardt v. Colorado Nat'l Bank*, 52 B.R. 229, 233 (Bankr. D. Colo. 1985)).

We construe this statute broadly in order to effectuate the policies of the bankruptcy code. *Cf. In re Daniels-Head & Associates*, 819 F.2d 914, 918 (9th Cir. 1987) ("concept of relatedness under section 157 (c) (1) is a broad one"). We have no trouble concluding that this case is related to NWFX's bankruptcy for purposes of bankruptcy jurisdiction. This action clearly will impact the assets of the bankruptcy estate and the funds available for distribution in the bankruptcy. Accordingly the dispute is within the jurisdiction of the bankruptcy court. *See, e.g., Matter of Kubly*, 818 F.2d 643, 645 (7th Cir. 1987) (" 'related to' jurisdiction encompasses only dispues that affect the payments to the bankrupt's other creditors or the administration of the bankrupt's estate").

B. Merits

We are in a unique position in this case because not only do we have circuit precedent to look to in guiding our decision but we have two cases which originated from the

[3] 28 U.S.C. § 157 (c) (1) (Supp. V 1987) provides:

> A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

very bankruptcy which spawned the instant appeal. In *NWFX I*, a panel of this court was faced with a similar problem when a chain of grocery stores refunded proceeds from the sale of NWFFX money orders to its customers holding dishonored NWFX money orders. In *NWFX I* the bankruptcy court held that moneys retained by the seller of NWFX's money orders did not constitute property of NWFX's bankruptcy estate and therefore was not subject to an order of turnover. *NWFX I*, 864 F.2d at 589.

The bankruptcy court reached this conclusion after it determined that there was not a valid contract between NWFX and the grocery store. In the absence of a valid contract NWFX had no legal interest in the proceeds generated from the sale of its money orders, the bankruptcy court concluded. Therefore the proceeds were not property of NWFX's bankruptcy estate.

In *NWFX I* this court reversed that portion of the bankruptcy court's order noting that while NWFX did not have a legal interest in the proceeds in the absence of a valid contract, NWFX did have an equitable interest in the funds based on quasi-contract principles. The panel in *NWFX I* ordered the grocery store to turn over proceeds from the sale of NWFX money orders that were still in its possession. *Id.* at 592.

> On the issue of the refunded proceeds, however, no basis appears upon which such proceeds can be ordered turned over. Because [the retailer] has refunded that amount, it cannot be said to be unjustly enriched. As to the proceeds not yet paid out, they should now be remitted to the estate except to the extent that [the retailer] can clearly establish obligations to make further refunds during the life of the money orders. This is because retention in the absence of refunding unjustly enriches [the retailer], and because the estate apparently has claims against it from the holders of these unredeemed money orders.

Id. at 591-92.

In contrast, another panel of this court in *NWFX II* held that moneys refunded by sellers of NWFX money orders to their money order customers were subject to turnover to the NWFX bankruptcy estate and the sellers were not entitled to an equitable set off equal to the amount refunded to their customers. *NWFX II* 864 F.2d at 595-96. The panel stated that the seller "was under no obligation to refund any money to buyers of dishonored money orders. On the contrary, refunding such amounts was a breach of its trust agreement." *Id.* at 596.

The panel in *NWFX II* also rejected the money order seller's argument that the doctrine of recoupment applied and entitled it to retain the proceeds from the money order sales which equaled the amount of the refunds made to its money order customers. The panel held that for the doctrine to apply "the creditor must have a claim against the debtor that arises from the same transaction as the debtor's claim against the creditor." 864 F.2d at 597 (citation omitted). The court rejected the application of the recoupment doctrine on these facts because

> [the retailer] cannot show that its claim and the claim of the trustee arose from the same transaction. [The retailer] acquired the funds in question from its sales of the debtors' money orders. Its claim against the debtors arose from voluntary refunds made to its own customers. The doctrine of recoupment cannot be applied to give [the retailer] a preference over the other creditors in this bankruptcy.

Id.

In dissent from the panel opinion in *NWFX I*, Senior Judge Sneed of the Ninth Circuit, sitting by designation, explained how he would handle the issue of the refunds made by the money order sellers.

> The record in this case does not suggest that Rice [, the money order seller,] had an obligation to refund

> its customers. It was not a guarantor of the money orders it sold. Holders of Northwest's money orders have claims against Northwest, not Rice. Rice therefore should have turned over to Northwest all of the proceeds from its money order sales. Its decision not to do so kept its customers happy and maintained its good will at no cost to it. Northwest's creditors, other than Rice's customers, provided the funds by which Rice enhanced its reputation. Rice's customers have received paymemt in full on their claims against Northwest while all other creditors of Northwest will not.
>
> * * * The majority holds that a party is unjustly enriched, not to the extent it has received money, but to the extent the money received has not been dissipated. * * *
>
> My result would not impose on Rice a double liability, one to its customers and another to Northwest. Although the issue is not before the court, Rice, after reimbursing its customers, could assert their claims against Northwest. Rice could argue either that the customers assigned to Rice their money order claims or that Rice acquired the customer's claims under a theory of equitable subrogation. To the extent that Rice would not receive full payment on these claims in the bankruptcy court at distribution, to that extent it would have paid for the maintenance of its goodwill. Moreover, it would have paid for it with its own money.

864 F.2d at 592 (citation omitted).

We have carefully reviewed the panel opinions in *NWFX I* and *NWFX II* and we conclude that there are no significant factual differences which would justify the different conclusions reached in these two cases. Yet, our reading of the two panel opinions leaves us with the inescapable conclusion that the opinions are not consistent with one another. *NWFX I* does not require the money

order sellers to turn over the amount of the refunds made to money order purchasers while *NWFX II* does.

While the decision in *NWFX I* was premised on a finding that there was no contract between NWFX and its money order seller, the panel nevertheless concluded that NWFX had an equitable interest in moneys retained by the money order seller. Once that conclusion is reached, we do not think there is any way to distinguish *NWFX I* from *NWFX II*.

Therefore we are confronted with what we perceive are two conflicting cases either one of which, in the absence of the other, would be controlling precedent in the instant case.

The inconsistency in these cases seems to have its origin in the bankruptcy court. In *NWFX I* the bankruptcy court held that moneys retained by the money order seller were not property of NWFX's bankruptcy estate. However, the same bankruptcy judge in *NWFX II* held that proceeds retained by a money order seller was property of the bankruptcy estate. In *NWFX II*, the bankruptcy court fashioned an equitable remedy which allowed the money order seller to set off the amounts that it refunded to money order purchasers against amounts it owed to the bankruptcy estate. The bankruptcy court in the *NWFX II* appeal held that money collected from the sale of NWFX money orders and held by the money order sellers "could be used as 'equitable setoffs' against post-petition sums paid by [the retailers] from their own funds to their customers who had purchased money orders that were ultimately dishonored." 864 F.2d at 594.

Then, in the instant case, the same bankruptcy court again concluded that proceeds held by the money order seller were property of the bankruptcy estate. The court, however, did not allow the money order seller to set off the moneys that it refunded to its customers. All of these

holdings in the three cases were affirmed by the same district judge.

Absent an en banc hearing to determine the matter, we conclude that the reasoning in *NWFX I* should be employed to resolve the instant appeal. In the instant case the bankruptcy court noted that the NWFX-Pyburn agreement does not indicate whether Arkansas or Texas law should be applied to interpret the agreement. In this respect the agreement between NWFX and Pyburn differed from the November 1984 agreement that NWFX had with Rice Food Markets which was at issue in *NWFX I*. The bankruptcy court relied primarily on Arkansas law in its decision. However, it also concluded that the result it reached would be the same whether Arkansas or Texas law were applied. We believe that under the applicable choice of law principles Texas law should be applied in interpreting the NWFX-Pyburn agreement. The parties' repeated reference to Arkansas law in their briefs suggests that they assume that Arkansas law controls the interpretation of the NWFX-Pyburn agreement. We believe this is an erroneous assumption.

In *Union Nat'l Bank v. Federal Nat'l Mortg. Ass'n*, 860 F.2d 847, 853 n.13 (8th Cir. 1988), this court noted that when deciding the choice of applicable state law district courts are obligated to apply the choice of law principles of the state in which they sit. The court continued: "Therefore, Arkansas choice of law principles apply. Since the agreement of the parties did not specify the law to be applied, a 'significant contacts' or 'center of gravity' test is appropriate." *Id.* (citations omitted).

In *Aetna Life Ins. Co. v. Great Nat'l Corp.*, 818 F.2d 19 (8th Cir. 1987), this court was required to determine whether Arkansas or Texas law governed a loan agreement. We noted that

> Arkansas has applied three different theories in determining what law governs a multi-state

> contract: (1) the law of the state in which the contract was made; (2) the law of the state in which the contract is to be performed; and (3) the law of the state which the parties have intended to govern the contract.

Id. at 20 (citing *Cooper v. Cherokee Village Development Co.*, 364 S.W.2d 158, 161-62 (Ark. 1963)).

We believe that under Arkansas choice of law principles Texas law should be applied to the NWFX-Pyburn agreement. The agreement between NWFX and Pyburn was executed and performed in Texas. Furthermore, the state of Texas has a substantial interest in this dispute as evidenced by the filing of an amicus curiae brief by the Texas Attorney General.[4]

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[4]Texas' strong interest in this dispute and its subject matter is also illustrated by the fact that just three weeks after NWFX filed its bankruptcy petition a bill was introduced in the Texas House of Representatives to amend the Texas Sale of Checks Act. *See* Texas Sale of Checks Act: Hearings on H.B. 64 Before the Committee on Financial Institutions, 69th Leg., 2nd C.S. (Aug. 26, 1986) (statement of Rep. Granoff). The amendment was a direct and immediate response to the NWFX bankruptcy which left thousands of Texas citizens holding "hot" money orders. H.B. 64, House Debate and second and third reading of H.B. 64, 69th Leg., 2nd C.S. (Sept. 1, 1986) (statement of Rep. Granoff). The amendments when finally passed provided, among other things, that

> Agents of licensees shall hold in trust from the moment of receipt the proceeds of a sale or delivery of the licensee's checks. An agent may not commingle the proceeds with his own property or funds, except to use the funds in the ordinary course of its business for the purpose of making change. If any agent of a licensee commingles any proceeds received from the sale of checks issued by the licensee with any other funds or property owned or controlled by the agent, all commingled proceeds and other property shall be impressed with a trust in favor of the licensee in an amount equal to the amount of the proceeds due the licensee from the sale of checks less the amount due the agent from the sale. In the event that a licensee's license is revoked by the Commissioner pursuant to Section 14, all sales proceeds then held in trust by agents of that licensee shall be deemed to have been assigned to the Commissioner.

Tex. Rev. Civ. Stat. Ann. art. 489d, § 9C (1987 Supp.).

The bankruptcy court concluded that NWFX was not in breach of the contract when its money orders were dishonored. We believe that this conclusion was erroneous. The agreement between NWFX and Pyburn established an agency relationship between them wherein NWFX was the principal and Pyburn was its agent. Therefore, in the absence of specific provisions in the agreement, we look to general agency principles to define the extent of the relationship between NWFX and Pyburn.

The comments to section 442 of the Restatement of the Law of Agency provide that "a failure of the principal to continue the employment because of his bankruptcy is ordinarily a breach of contract." Restatement (Second) of Agency § 442 comment e (1958), *see also* Restatement (Second) of Agency § 450 comment b (bankruptcy of the principal, whether or not voluntary, is a breach of contract if it renders performance impossible).

In addition, section 437 of the Restatement of the Law of Agency provides:

> Unless otherwise agreed, a principal who has contracted to employ an agent has a duty to conduct himself so as not to harm the agent's reputation nor to make it impossible for the agent, consistently with his reasonable self-respect or personal safety, to continue in the employment.

Restatement (Second) of Agency § 437 (1958).

The comments to this section state that "the agent is justified in assuming that the principal has and will maintain for himself and his business a standard of conduct which will not harm the agent's reputation or reasonable self-respect if he continues to act as agent." *Id.* comment a. Furthermore, "[a]n agent employed by a seemingly reputable principal has no duty to continue to act as agent if he subsequently learns that the principal's business is fraudulent or otherwise unlawful, as where a teller in a

bank learns that the bank is violating the statutes passed for the protection of depositors." *Id.* comment b. The Restatement also comments that "[s]eriously improper conduct by the principal, whether or not tortious, towards an agent employed by him under contract is a breach of contract." *Id.* comment d.

In the instant case NWFX breached its agreement with Pyburn when it became insolvent and filed for bankruptcy. Furthermore, although the trustee for NWFX did not desire to get into the details of NWFX's conduct, there appears to be some indication that NWFX was involved in fraudulent activity. NWFX's bankruptcy was hastened by an order of the Arkansas Securities Commission which suspended NWFX's license to do business in Arkansas.[5] Shortly thereafter, the bank through which NWFX's money orders cleared ceased its business relationship with NWFX and then closed its account. Thus, NWFX's bankruptcy rendered performance under the NWFX-Pyburn agreement impossible and constituted a breach. Pyburn was also relieved of its obligation to act as NWFX's agent when it heard that NWFX may have been involved in fraudulent activity. The dishonor of the NWFX money orders caused considerable harm to Pyburn's reputation and the goodwill it enjoyed with its customers. NWFX's bankruptcy and improper conduct made it impossible for Pyburn to continue to act as its agent.

Moreover, the statements made by NWFX to Pyburn that money order sales should be discontinued and its subsequent conduct may have established an anticipatory breach by NWFX. *See, e.g.*, Restatement (Second) of Agency § 450 comment c.

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[5]There is also reason to believe that NWFX may have been in violation of the Texas Sale of Checks Act because its license to do business under the Act was revoked shortly after the NWFX money orders were dishonored.

We also believe that when NWFX's money orders were dishonored NWFX breached an implied covenant of good faith which is inherent in the NWFX-Pyburn contract. While the Texas Supreme Court has rejected the theory that all contracts embody an implied covenant of good faith and fair dealing, *see English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983), such a covenant has been implied when certain special relationships exist. One such relationship "arises from the element of trust necessary to accomplish the goals of the undertaking * * * *" *Id.* at 524 (Justice Spears, concurring). We believe that the relationship of principal and agent which existed between NWFX and Pyburn embodied the element of trust which would carry with it an obligation of good faith and fair dealing. *See, e.g., Kinzbach Tool Co., Inc. v. Corbett-Wallace Corporation*, 160 S.W.2d 509, 514 (Tex. 1942) (good faith and fair dealing required from agent in every transaction on behalf of principal). We believe the element of trust requirement is also satisfied because NWFX was operating in a business heavily regulated by the State of Texas. NWFX was a licensee under the provisions of the Texas Sale of Checks Act, Tex. Rev. Civ. Stat. Ann. art. 489d *et seq.* (Vernon 1985).[6] Thus, we conclude that when NWFX's money orders were dishonored, NWFX breached an implied covenant of good faith and fair dealing implicit in its contract with Pyburn.

Furthermore, we believe that the contract between Pyburn and NWFX would be void as against public policy if it were interpreted to allow NWFX to issue money orders without a corresponding obligation to honor those money orders when they were presented for payment. *See, e.g., English v. Fischer*, 660 S.W.2d at 525 (Justice Spears,

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[6]The Texas Sale of Checks Act requires licensees to have a minimum net worth and to establish their financial responsibility, business experience, character, and general fitness so as to warrant the belief that the licensee's business will be conducted honestly, carefully, and efficiently. Tex. Rev. Civ. Stat. Ann. art. 489d, § 5. Licensees are also required to post a bond with a state agency. *Id.* at § 9.

concurring) ("In situations where the duty of good faith and fair dealing does exist, public policy would dictate that it cannot be disclained."). Under Texas law, as in most other jurisdictions, contracts which are contrary to public policy are void. "Expressions of public policy are found in a state's constitution, statutes and judicial decisions." *Locomotive Eng'r. & Conductors Mut. Protective Ass'n v. Bush*, 576 S.W.2d 887, 890 (Tex. Civ. App. 1979) (citations omitted). An agreement that allowed NWFX to issue money orders without any obligation to honor them would be inconsistent with NWFX's obligations as a licensee under the Texas Sale of Checks Act which provides that "[e]ach licensee shall be liable for the payment of all checks which he sells, in whatever form and whether directly or through an agent * * * *" Tex. Rev. Civ. Stat. Ann. art. 489d, § 12.

Therefore, we disagree with the bankruptcy court's conclusion that NWFX was not in breach of its contract with Pyburn. NWFX's breach of the contract with Pyburn was a material breach that discharged Pyburn from its obligation to perform. *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 689 (Tex. 1981) ("Default by one party excuses performance by the other party."). Thus, Pyburn was entitled to take all actions necessary to minimize the adverse consequences of NWFX's breach. Once again we look to general principles of agency law to determine the appropriateness of Pyburn's actions.

Section 439 of the Restatement of the Law of Agency provides:

> Unless otherwise agreed, a principal is subject to a duty to exhonorate an agent who is not barred by the illegality of his conduct to indemnify him for:
>
> * * *
>
> (e) payments resulting in benefit to the principal, made by the agent under such circumstances that it would be inequitable for indemnity not to be made.

Restatement (Second) of Agency § 439.

In addition, if an agent "acts in good faith, mistakenly believing that he is authorized or that his principal's interests require his action, he may be entitled to indemnity to the extent that the principal has benefited, in accordance with the principles of restitution." *Id.* comment i.

Thus, in the instant case because Pyburn made refunds to money order purchasers in good faith and for the benefit of its principal, NWFX, it would be entitled to indemnity from NWFX for the refunds.[7] Accordingly, we hold that the moneys refunded by Pyburn were not property of NWFX's estate and not subject to turnover.

Our conclusion is consistent with the panel opinion in *NWFX I* which applied principles of restitution and unjust enrichment to conclude that refunds made to purchasers of money orders under circumstances similar to those in the case at bar were not subject to turnover to the bankruptcy estate. Similarly, the *NWFX I* panel held that moneys retained by the money order seller after it made refunds to its customers were subject to turnover to the bankruptcy estate.

In sum, the only interest, as defined by state law, that NWFX had in the moneys held by Pyburn was an equitable interest in the $18,451.66 which was the amount held by Pyburn from the sale of money orders remaining after it made refunds to money order purchasers. Therefore, this amount was properly turned over to the bankruptcy trustee.

Accordingly, we hold that the $18,451.66 which Pyburn tendered at the commencement of the trial before the bankruptcy court was properly subject to turnover to the bankruptcy estate. These funds represented proceeds from

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[7]Pyburn's good faith is best illustrated by the fact that it prepared a release for its benefit and the benefit of NWFX which purchasers of money orders were required to execute before receiving a refund.

the sale of NWFX's money orders which were not returned to purchasers of the money orders. However, we do not agree that the proceeds from the sale of NWFX money orders which were ultimately refunded to holders of dishonored money orders were properly subject to the bankruptcy court's turnover order.

III. CONCLUSION

We conclude that the proceeds from the sale of NWFX money orders which were refunded to purchasers of dishonored money orders were not subject to turnover to NWFX's bankruptcy estate. Accordingly, we affirm in part and reverse in part the order of the district court and remand this matter to the district court for further proceedings consistent with this opinion.

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION
(Filed Aug. 1, 1988)

IN RE: NWFX, INC., No. FA 86-148 F

Debtor

ALLEN W. BIRD II, TRUSTEE FOR
NORTHWEST FINANCIAL EXPRESS, INC.,
NWFX, INC. and GOLD FINANCIAL
EXPRESS, INC. PLAINTIFF

v. No. AP 86-484

CROWN CONVENIENCE,
DERBY REFINING, ET AL. DEFENDANT

ORDER

Now on this 29th day of July, 1988, comes on for consideration the proposed findings and recommendations filed herein on June 21, 1988, by the Honorable Robert F. Fussell United States Bankruptcy Judge for the Eastern and Western Districts of Arkansas. Ten (10) days having passed without objections being filed by the parties, the court hereby adopts *in toto* the findings and recommendations.

Accordingly, the court finds that judgment should be entered against Pyburn Enterprises, Inc. in the amount of $70,600.62. Further, the court finds the Trustee is entitled to recover prejudgment interest at the rate of 6% per annum from August 3, 1986, until April 26, 1988, on the amount $9,052.28 and from April 27, 1988, until judgment on the amount of $70,600.62. Such judgment shall bear interest

at the applicable post-judgment interest rate as set forth in 28 U.S.C. §1961.

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION
(Filed June 21, 1988)
(Entered June 23, 1988)

IN RE: NWFX, INC., No. FA 86-148 F

Debtor

ALLEN W. BIRD II, TRUSTEE FOR NORTHWEST FINANCIAL EXPRESS, INC., NWFX, INC. and GOLD FINANCIAL EXPRESS, INC. PLAINTIFF

v. No. AP 86-484

CROWN CONVENIENCE, DERBY REFINING, et al. DEFENDANTS

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING THE BREACH OF CONTRACT CLAIM AGAINST PYBURN, INC.

Upon plaintiff's Complaint and other pleadings filed in this action, and upon the trial held on April 26, 1988, where evidence was introduced, the Court submits the following proposed findings of fact and conclusions of law in accordance with 28 U.S.C. §157 (c) (1) regarding the issue of the breach of contract by Pyburn Enterprises, Inc. The Court has made separate Proposed Findings of Fact and Conclusions of Law regarding the trustee's entitlement to prejudgment interest which has been entered of even date.

FINDINGS OF FACT RECOMMENDED FOR ADOPTION BY THE UNITED STATES DISTRICT COURT REGARDING THE BREACH OF CONTRACT ISSUE

1. Northwest Financial Express, Inc., ("NWFX") and Pyburn Enterprises, Inc. ("Pyburn") executed a Trust Agreement ("Agreement") on December 8, 1983, wherein Pyburn agreed to act as an agent of NWFX in the sale of NWFX's money orders.

2. Pursuant to the Agreement, Pyburn was to sell money orders, hold in trust all money received by Pyburn from the sale of such money orders for the benefit of NWFX, prepare weekly settlement reports of the sale of money orders and remit all funds received plus $ .22 per money order to debtor along with the settlement report.

3. Up until late July 1986, Pyburn sold NWFX, Inc. money orders, reported sales and remitted money order proceeds to debtor in accordance with the Agreement.

4. Pyburn's weekly reports for the months of April 1986 through August 1986 confirmed that Pyburn was selling NWFX, Inc. money orders through July 1986.

5. On or about July 25, 1986, the bank through which the NWFX money orders cleared ceased to continue its relationship with NWFX and NWFX's account was closed. At that time, NWFX discontinued its operations.

6. On August 1, 1986, NWFX filed a petition for relief under chapter 11 of the Bankruptcy Code.

7. The Agreement between the parties remained in effect up through the date of NWFX's petition for bankruptcy.

8. Plaintiff is the duly appointed and acting trustee of NWFX's estate, appointed by the United States Bankruptcy Court for this district.

9. Pyburn failed to send to NWFX proceeds from the sale of money orders as required by the Agreement.

10. Instead of remitting the proceeds, Pyburn collected $89,052.28 from the sale of NWFX, Inc. money orders, made refunds to its customers who held dishonored money orders in the amount of $70,600.62 and held the remainder of $18,451.66.

11. The amount of proceeds from the sale of money orders which Pyburn failed to remit to NWFX totals $89,052.28.

12. At trial, Pyburn tendered a check in the amount of $18,451.66 made payable to the trustee.

13. When the $18,451.66 amount is applied to the $89,052.28, $70,600.62 remains unpaid.

CONCLUSIONS OF LAW RECOMMENDED FOR ADOPTION BY THE UNITED STATES DISTRICT COURT REGARDING THE BREACH OF CONTRACT CLAIM AND THE ENTITLEMENT TO PREJUDGMENT INTEREST ISSUE

1. A contract existed between debtor and Pyburn wherein Pyburn was to sell NWFX, Inc. money orders, hold such proceeds in trust for debtor and remit settlement reports detailing the sales of money orders along with the proceeds from the sale of such money orders to debtor on a weekly basis.

2. Pyburn breached the contract with debtor by failing to remit proceeds from the sale of money orders totalling $89,052.28.

3. Debtor did not breach the Agreement when the money orders were dishonored, and as such, Pyburn's defense to its contractual liability is ineffective.

4. As a matter of law, plaintiff is entitled to judgment based on the proceeds collected by Pyburn from the sale of NWFX, Inc. money orders which Pyburn failed to forward to debtor or plaintiff.

5. Plaintiff's damages for breach of the Agreement by Pyburn totalled $89,052.28.

6. This amount of $89,052.28 was reduced to $70,600.62 at trial by Pyburn's remittance of $18,451.66 to trustee.

7. The trustee is entitled to judgment in the amount of $70,600.62 plus prejudgment interest as recommended in the accompanying "Proposed Findings of Fact and Conclusions of Law Regarding the Entitlement of Prejudgment Interest from Pyburn Enterprises, Inc."

/s/ Robert F. Fussell
ROBERT F. FUSSELL
UNITED STATES BANKRUPTCY
JUDGE

DATE: June 17, 1988

cc: M. Elizabeth Goff, Esq.
1500 Tower Building
Little Rock, AR 72201

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IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION
(Filed June 21, 1988)
(Entered June 23, 1988)

IN RE: NWFX, INC., No. FA 86-148 F

Debtor

ALLEN W. BIRD II, TRUSTEE FOR NORTHWEST FINANCIAL EXPRESS, INC., NWFX, INC. and GOLD FINANCIAL EXPRESS, INC. PLAINTIFF

v. No. AP 86-434

CROWN CONVENIENCE, DERBY REFINING, et al. DEFENDANTS

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING THE ENTITLEMENT OF PREJUDGMENT INTEREST FROM PYBURN ENTERPRISES, INC.

Before the Court is the Amended Complaint of Allen W. Bird II, Trustee for NWFX, Inc., Northwest Financial Express, Inc. and Gold Financial Express, Inc. (NWFX) against the separate defendant, Pyburn Enterprises, Inc. (Pyburn), in the above adversary proceeding. In his complaint, the trustee seeks damages against Pyburn for breach of a contract between the debtor, NWFX, and Pyburn where Pyburn served as an agent for the sale of NWFX's money orders.

Previously, this Court concluded that it had jurisdiction over the trustee's Amended Complaint pursuant to 28 U.S.C. § 157 (c) (1) as a non-core proceeding about which it could submit proposed findings of fact and conclusions of law to the district

court. At the trial held April 26, 1988, regarding Pyburn, this Court recommended that the trustee be entitled to damages resulting from Pyburn's breach of contract in the amount of $89,052.28. The Court took under advisement a request by the trustee for payment of prejudgment interest on the judgment amount.

Findings of Fact

The following facts are relevant for a determination of the trustee's entitlement to prejudgment interest. The debtor, NWFX, filed voluntary chapter 11 proceedings on August 1, 1986. On the date of filing, NWFX, as a [sic] the debtor-in-possession, filed an adversary proceeding seeking, in essence, a turnover of monies, money orders and supplies held by various agents, including Pyburn, from the sale of money orders. Allen W. Bird II subsequently was appointed trustee.

This particular action arises from the trustee's amended complaint filed on August 28, 1987, alleging a breach of contract by Pyburn. In the amended complaint, the trustee has sought damages for the breach, along with "interest at the rate of ten percent (10%) per annum from August 1, 1986." Trial of the complaint was conducted on April 26, 1988.

The trustee also submitted an exhibit which reflected the amount owing as a result of Pyburn's breach of contract as of August 3, 1986, to be $89,052.28. See Trustee's Exhibit No. 2. At trial, Pyburn tendered a check in the amount of $18,451.66, representing funds which it held from the sale of money orders which had not been remitted to NWFX to be applied toward the amount of $89,052.28. At trial, the contract between NWFX and Pyburn was admitted into evidence. A review of the agreement indicates no specific provisions were made for interest. See Trustee's Exhibit No. 1.

Conclusions of Law

The test in prejudgment interest cases is whether there is a method for determining of the value of the

property at the time of the injury or loss. *Lovell v. Marianna Federal Savings & Loan Ass'n*, 267 Ark. 164, 266-67, 589 S.W.2d 577, 578 (1979); *Toney v. Haskins*, 7 Ark. App. 98, 108, 644 S.W.2d 622, 627 (Ark. Ct. App. 1983). Where damages are capable of computation both as to the time of the loss and the amount of the loss, prejudgment interest is allowable. *Hopper v. Denham*, 281 Ark. 84, 90, 661 S.W.2d 379, 383 (1983); *Brown v. Summerlin Assoc., Inc.*, 272 Ark. 298, 302, 614 S.W.2d 227, 230 (1981). If prejudgment interest is allowable, then a party is entitled to interest under Arkansas law, according to article 18, §13 of the Arkansas Constitution at the rate of 6% per annum. *Wilson v. Lester Hurst Nursery, Inc.*, 269 Ark. 19, 21-22, 598 S.W.2d 407, 408 (1980); *Lovell v. Marianna Federal Savings & Loan Ass'n.*, 267 Ark. at 168, 589 S.W.2d at 578. The contrary is also true. Where damages are not readily ascertainable at the time of a loss, prejudgment interest is not allowable. *Lovell v. Marianna Federal Savings & Loan Ass'n*, 267 Ark. at 167, 589 S.W.2d at 578. *See also Jennings v. Dumas Public School Dist.*, 763 F.2d 28, 33 (8th Cir. 1985).

The reason for allowing prejudgment interest is to compensate an injured party for its loss. The time of the loss is used to determine the value of the loss. When there is a delay in compensating an injured party, the injured party has an additional loss for the time in which the party was deprived of the use of the property. *Wilson v. Lester Hurst Nursery, Inc.*, 269 Ark. at 23, 598 S.W.2d at 408 (1980);

Lovell v. Marianna Federal Savings & Loan Ass'n., 267 Ark. at 266-67, 589 S.W.2d at 578.[1]

In the present case, Pyburn breached its contract with NWFX when it failed to remit $89,052.28 owed under the contract from the sale of money orders. The records of NWFX reflect that as of August 3, 1986, the amount of $89,052.28 was ascertainable and owing by Pyburn to NWFX from the sale of money orders. NWFX was denied the benefit of these monies as a result of Pyburn's breach of contract. The trustee is entitled to prejudgment interest from the date on which the amount of $89,052.28 was ascertainable, or August 3, 1986, until August 26, 1988, until the date of trial. At trial, Pyburn tendered a check to the trustee in the amount of $18,451.66. This amount reduced the total judgment amount, without prejudgment interest, to $70,600.62. The trustee is entitled to prejudgment interest on the amount of $70,600.62 until the date of judgment.

The trustee has sought prejudgment interest at the rate of 10% per annum. The trustee is entitled to

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[1]The contract between Pyburn and NWFX does not indicate whether the laws of Texas or Arkansas should be applied to interpret the parties' rights under the contract. In this instance, the Court notes that the result would be the same, whether Arkansas law or Texas law were applied. *See, e.g., Black Lake Pipe Line Co. v. Union Const. Co.*, 538 S.W.2d 80, 95-96 (Tex. 1976) (where damages are established as of a definite time and amount, prejudgment interest is recoverable as a matter of right from the date of injury or loss); *Great State Petroleum, Inc. v. Arrow Rig. Serv., Inc.*, 706 S.W.2d 803, 810-11 (Tex. Civ. App. 1986) (prejudgment interest may be awarded when party's damages are established at definite time and amount of damages are definitely determinable); *Okemah Const. Inc. v. Barkley-Farmer, Inc.*, 583 S.W.2d 458, 461 (Tex. Civ. App. 1979) (where definite sum is due and payable at date certain prior to judgment, legal rate of interest should be allowed from such date to judgment date); *Pickens v. Alsup*, 568 S.W.2d 742 (Tex. Civ. App. 1978) (test for determining allowance of prejudgment interest is whether the measure of the claim is fixed by conditions existing at time injury arose). *See also* Tex. Rev. Civ. Stat. Ann. art. 5069-1.01, 5069-1.03 (Vernon 1979).

prejudgment interest at the rate of 6% per annum, not 10% per annum, however, under Article 18, §13 of the Arkansas Constitution. Therefore, the prejudgment interest should be calculated at the rate of 6% per annum from August 3, 1986.

The Court notes that in this case, it may seem inequitable for the trustee to be allowed to recover prejudgment interest, especially in light of testimony received at trial regarding the fact that Pyburn's failure to remit proceeds to the trustee was based on reliance of the advice of the Attorney General for the State of Texas and other officials. However, where prejudgment interest is collectible at all, an injured party is entitled to prejudgment interest as a matter of law. *Wooten v. McClendon*, 272 Ark. 61, 62, 612 S.W.2d 105, 106 (1981); *Toney v. Haskins*, 7 Ark. App. 98, 108, 644 S.W.2d 622, 627 (Ark. Ct. App. 1983). Therefore, this Court recommends that the United States District Court allow prejudgment interest at the rate of 6% per annum from August 3, 1986, until April 26, 1988, on the amount of $89,052.28 and from April 27, 1988, until judgment on the amount of $70,600.62.

/s/ Robert F. Fussell
ROBERT F. FUSSELL
UNITED STATES BANKRUPTCY
JUDGE

DATE: June 17, 1988

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IN RE NWFX, INC.

Cite as 864 F.2d 593 (8th Cir. 1989)

In re NWFX, INC., Debtor.

Allen W. BIRD, II, Trustee in Bankruptcy for Northwest Financial Express, Inc., NWFX, Inc., Gold Financial Express, Inc., Appellant,

v.

CARL'S GROCERY COMPANY, INC., Appellee.

In re NWFX, INC., Debtor.

Allen W. BIRD, II, Trustee in Bankruptcy for Northwest Financial Express, Inc., NWFX, Inc., Gold Financial Express, Inc. Appellee,

v.

CARL'S GROCERY COMPANY, INC., Appellant.

In re NWFX, INC.

NORTHWEST FINANCIAL EXPRESS, INC.; NWFX, Inc.; Gold Financial Express, Inc., Appellants,

v.

HANDY ANDY SUPERMARKETS, J.V., Appellee.

Nos. 88-1140, 88-1244 and 88-1650.

United States Court of Appeals, Eighth Circuit.

Submitted Sept. 22, 1988.

Decided Jan. 5, 1989.

Before McMILLIAN, WOLLMAN and MAGILL, Circuit Judges.

McMILLIAN, Circuit Judge.

Allen W. Bird II, Trustee in Bankruptcy for Northwest Financial Express, Co., Inc., NWFX, Inc., and Gold Financial Express, Inc., (Trustee) appeals from a final judgment entered in the District Court[1] for the Western District of Arkansas affirming the orders of the Bankruptcy Court[2] for the Western District of Arkansas, Fayetteville Division. The Bankruptcy Court held that certain sums of money collected from money order sales and held in trust for the debtors by Handy Andy Supermarkets, J.V. (Handy Andy) and Carl's Grocery Co., Inc. (Carl's) could be used as "equitable setoffs" against post-petition sums paid by the two grocery store creditors from their own funds to their customers who had purchased money orders that were ultimately dishonored. The bankruptcy court also held that Carl's could retain certain pre-petition sums as an exception to turnover pursuant to 11 U.S.C. § 542 (c).

For reversal, the trustee argues (Nos. 88-1140, 88-1650) that the district court erred in affirming the equitable setoff remedy where no mutuality of debt existed and that it misconstrued the § 542 (c) exception to turnover. Carl's cross-appeals (No. 88-1244) from the portion of the order disallowing an equitable setoff for certain sums paid by Carl's for money orders used to make its beer purchases. For reversal, Carl's argues that the district court should have applied the common law doctrine of recoupment. For the reasons discussed below, we reverse the judgment of

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[1]The Honorable H. Franklin Waters, Chief Judge, United States District Court for the Western District of Arkansas.

[2]The Honorable Robert F. Fussell, United States Bankruptcy Judge for the Western District of Arkansas.

the district court with respect to the direct appeal and affirm the judgment of the district court with respect to the cross-appeal.

Background

These consolidated cases arise out of the bankruptcy of three related corporations, Northwest Financial Express, Inc., NWFX, Inc., and Gold Financial Express, Inc., (debtors). These corporations had sold money orders prior to their bankruptcies. The money orders represented obligations of the debtors to pay the face values of the money orders to the holders of the money orders. Various supermarkets and convenience stores, of which Handy Andy and Carl's were two, were the agents of the debtors for the sale of these money orders.

Every time a money order was sold, the selling agent would collect the face value of the money order plus a fee. These amounts were held in trust for the debtors pursuant to written trust agreements between the debtors and their agents. From time to time the agents would remit to the debtors the face amount of money orders sold plus a portion of the fees collected. The agents would retain their portions of the fees.

On July 27, 1986, the debtors notified Handy Andy by telephone that no more of their money orders should be sold. Handy Andy immediately quit selling the money orders. This telephone notice was confirmed by mailgram on July 29, 1986. The debtors filed bankruptcy petitions on August 1, 1986, at which time Handy Andy held in a separate account $141,881.34 that it had previously collected from the sale of the debtors' money orders. Handy Andy received official notice of the bankruptcy on August 13, 1986. Both before and after the filing of debtors' petitions in bankruptcy, Handy Andy reimbursed its customers for purchases of dishonored money orders. These

refunds are in excess of $290,000. The bankruptcy court, pursuant to its § 105 equitable powers, allowed Handy Andy to retain the $141,881.34 still in its possession as an "equitable setoff" against the amounts it had refunded.

Carl's quit selling the debtors' money orders on July 26, 1986, and was formally notified by mailgram to stop selling the money orders on July 29, 1986. On the date of the filing of the petitions in bankruptcy, Carl's held $57,075.61 in funds it had collected from the sale of debtors' money orders. Like Handy Andy, Carl's chose to make refunds to its customers who held dishonored money orders. A total of $15,277.28 was refunded by Carl's to its customers from its own funds after the petitions in bankruptcy had been filed.

Carl's also acted as the collection agent of several utility companies. Carl's collected the utility payments from its customers and then purchased a money order from the debtors for payment of the utility bills in one lump sum. After money orders it had purchased for this purpose were dishonored, Carl's paid $5,593.31 of its own funds to the utility companies. The bankruptcy court allowed Carl's an equitable setoff pursuant to § 105 in the amount of $20,870.59, the sum of the amounts reimbursed to customers and paid to the utility companies.

Additionally, some $1,665.69 had been refunded to customers by Carl's before Carl's received notice of the petition in bankruptcy. The bankruptcy court allowed Carl's to withhold this amount from the monies it held in trust for the debtors pursuant to the § 542 (c) exception to turnover.

Finally, Carl's had purchased money orders for payments to its beer distributors of which $8,349.20 were dishonored. Carl's later paid the distributors in cash from its own funds. However, the bankruptcy court did not allow setoff of this amount against the sum held in trust by Carl's.

Equitable Setoff

The trustee argues that the full $141,881.34 held by Handy Andy along with the full $57,075.61 held by Carl's should be turned over to the trustee as property of the debtors' estates pursuant to 11 U.S.C. § 542 (a). We agree. The bankruptcy court properly held that neither Handy Andy nor Carl's was entitled to a setoff pursuant to 11 U.S.C. § 553 because such a setoff requires mutuality of debt. *In the Matter of Universal Money Order Co.*, 3 Bankr. Ct. Dec. (CRR) ¤05, 906 (Bankr.S.D.N.Y. 1977). Nevertheless, the bankruptcy court fashioned a so-called "equitable setoff" invoking its § 105 equitable powers.

Generally, the bankruptcy court possesses only the jurisdiction and powers conferred upon it by Congress, and its broad equitable powers may only be used to further the policies and provisions of the Code. *Johnson v. First National Bank*, 719 F.2d 270, 273 (8th Cir. 1983).

Section 105 (a) provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

Unquestionably, § 105 of the Bankruptcy Code allows the bankruptcy court to exercise broad powers in the administration of its cases. It is even broader than Section 2a (15) of the Bankruptcy Act from which it is derived. 2 Collier on Bankruptcy § 105.01 at 105-1 *et seq.* (15th ed.1983). Nevertheless, Chapter 1 of the Bankruptcy Code is essentially procedural. It does not set out substantive rights of the parties. 1978 U.S. Code Cong. & Admin.News, 5790.

[1] Section 105 is comparable to the All Writs Statute, 28 U.S.C. § 1651. Its purpose is to allow the bankruptcy court to issue equitable orders such as injunctions and stays

and to punish for contempt in cases where such actions are consistent with the provisions of the Code. Section 105 does not empower a bankruptcy court to create new substantive rights. *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986); *see also In re Perry*, 25 B.R. 817, 821 (Bankr.D.Md.1982).

[2] The overall structure of the Bankruptcy Code is designed to treat creditors equally. Every setoff by its very nature is a preference. Yet § 553 allows the bankruptcy court to recognize setoffs in certain situations where there is mutuality of debt. Even so, a bankruptcy court may disallow an otherwise proper § 553 setoff if there are compelling reasons for not allowing such a preference. We follow the reasoning of the Seventh Circuit in recognizing that there is no reason for enlarging the right to setoff beyond that allowed in the Code. *Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562 (7th Cir. 1986). An "equitable setoff" such as that fashioned by the bankruptcy court in the present case is not a proper use of the bankruptcy court's equitable powers because it creates new substantive rights for the parties and because such relief is not consistent with the provisions of the Code.

Exception to Turnover

We next examine Carl's right to retain $1,665.59, the amount of money refunded to purchasers of dishonored money orders by Carl's before Carl's received formal notice of the filing of the petition in bankruptcy. The bankruptcy court held that Carl's could retain these funds pursuant to the § 542(c) exception to turnover of property of the estate. The trustee argues that the § 542(c) exception does not apply to this case because the transfers were not made "in good faith" and because the use of the § 542(c) exception is not consistent with the underlying purposes of the exception. We agree.

Generally, any property of a debtor's estate held by any entity must be turned over to the trustee of the estate. 11 U.S.C. § 542(a). An exception to the general rule of turnover is found at § 542(c) which provides:

> [A]n entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith . . . , to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

In other words, if this exception were to apply, Carl's would be exempt from turning over to the trustee the amount of money it refunded to its money order customers before it received notice of the filing of the bankruptcy petition.

[3] The § 542(c) exception requires that the transfer be made "in good faith." The bankruptcy court found that Carl's relationship with the debtors was governed by an orally modified written agreement. This agreement provided that Carl's, as an agent of the debtors, would hold any funds received on behalf of the debtors in trust for the debtors. The agreement made no provision for Carl's to refund money to its customers in case the money orders were dishonored. For that reason, any such transfer would be a breach of the trust agreement and therefore could not be made in good faith.

The policy considerations behind the enactment of the § 542(c) exception do not support its use by Carl's. Section 542(c) is a codification of *Bank of Marin v. England*, 385 U.S. 99, 103, 87 S.Ct. 274, 277, 17 L.Ed.2d 197 (1966) (*Bank of Marin*), which held that a bank cannot be held liable for paying checks written before a depositor filed a voluntary bankruptcy petition, absent the bank's actual knowledge of the bankruptcy. The distinguishing factor in *Bank of Marin* is that a bank acts under a contractual duty to its depositor

to honor properly drawn checks. For that reason, the Court and Congress believed that it would be inequitable to require a bank to turn over to a bankruptcy estate a sum of money equal to amounts properly paid to third parties before the bank had received notice or actual knowledge of the debtor's bankruptcy.

Carl's, on the other hand, was under no obligation to refund any money to buyers of dishonored money orders. On the contrary, refunding such amounts was a breach of its trust agreement. Therefore, the § 542(c) exception to turnover does not apply to the $1,665.69.

Cross-appeal

We next consider the issues raised by Carl's on cross-appeal. Of these issues, only the doctrine of recoupment has any relevance to a bankruptcy proceeding. Carl's argues that the doctrine of recoupment may be applied to allow it to retain the funds in its possession. We disagree.

[4] The common law doctrine of recoupment is still important in bankruptcy. Where it is applicable, recoupment may be used to afford a creditor preferential treatment. For recoupment to apply, however, the creditor must have a claim against the debtor that arises from the same transaction as the debtor's claim against the creditor. *In re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986). In *In re B & L Oil Co.*, the creditor was allowed to recoup pre-petition overpayments to the debtor by withholding payments owed to the debtor for post-petition purchases. Moreover, in most cases where recoupment has been allowed, the parties were operating under a contract which specifically allowed recoupment. *Id.* [cites omitted].

Carl's cannot show that its claim and the claim of the trustee arose from the same transaction. Carl's acquired the funds in question from its sales of the debtors' money orders. Its claim against the debtors arose from voluntary

refunds made to its own customers. The doctrine of recoupment cannot be applied to give Carl's a preference over the other creditors in this bankruptcy.

Accordingly, the judgment of the district court is reversed in part and affirmed in part.

In Re: NWFX, INC., Debtor.

Northwest Financial Express, Inc.; NWFX, Inc.; and Gold Financial Express, Inc.

Allen W. BIRD, II, Trustee, Appellant,

v.

CROWN CONVENIENCE; Derby Refining Co., et al., Appellees.

No. 87-2360.

United States Court of Appeals, Eighth Circuit.

Submitted May 13, 1988.

Decided Nov. 30, 1988.

Before BEAM, Circuit Judge, and BRIGHT and SNEED,* Senior Circuit Judges.

*The HONORABLE JOSEPH T. SNEED, Senior United States Circuit Judge for the Ninth Circuit, sitting by designation.

BEAM, Circuit Judge.

Allen W. Bird, II, the Trustee for the bankruptcy estate of Northwest Financial Express (Northwest) appeals from an order of the district court holding that approximately $600,000 claimed by Northwest was not property of the estate and therefore not subject to an order of turnover under 11 U.S.C. § 542.

BACKGROUND

Northwest marketed money orders through retail grocery stores. The stores would sell money orders to their customers and then remit the proceeds to Northwest. Rice Food Markets, Inc., a grocery chain with stores located throughout the Houston, Texas, area, had an arrangement with Northwest.

In fact, in May of 1984, Rice and Northwest entered into a written agreement for Rice to sell Northwest's money orders. At that time, Northwest marketed money orders issued by Northwest National Bank. Each such money order was F.D.I.C. insured.

In November of 1984, Northwest converted to City National Bank money orders. Rice and Northwest entered into another written agreement, this time, concerning Rice issuing the City National Bank money orders to Rice customers. These money orders were also F.D.I.C. insured.

Pursuant to the written agreement of November of 1984, Rice would sell the money orders to its customers; deposit the currency in one of Rice's bank accounts, and collect interest on the money. Each Thursday, Rice would forward an amount equal to the face value of the money orders sold prior to the most recent Sunday. In addition, Rice would pay to Northwest 11 cents for each money order sold. Rice's compensation was the interest earned on the deposited proceeds between remittance dates plus any additional fee Rice might charge its customers for issuing the particular money order.

In May of 1985, Northwest began marketing its own "proprietary" money orders which were not F.D.I.C. insured. In essence, the new money orders were checks issued by Northwest in exchange for cash. These money orders were then payable at the Northwest National Bank

in Fayetteville, Arkansas, provided that Northwest had sufficient funds in its checking account at that bank.

Rice's customers generally used their money orders for paying many of the same bills for which other citizens write checks. The bulk of Rice's clientele, however, were people who did not maintain checking accounts. Between May of 1985 and July 28, 1986, Rice sold these customers the new Northwest proprietary money orders.

On July 28, 1986, Rice learned that Northwest would no longer honor its money orders. Between July 14, and July 28, 1986, Rice had issued $878,713.98 in money orders. Rice has since declined to remit $653,713.98 of the proceeds from these sales. Instead, Rice has been refunding all money orders purchased at its stores—either through arrangements with local banks to make good on Northwest money orders returned "not sufficient funds" (NSF), or by refunding their customers directly. As of November 30, 1986, Rice had paid out $541,658.77.[1]

On August 1, 1986, Northwest filed a petition in bankruptcy for protection under Chapter 11. The Trustee commenced this proceeding against Rice to force Rice to turn over the $653,713.98 to the estate. A hearing was held before the bankruptcy court on December 16, 1986, to

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[1]The concurring and dissenting opinion makes the point that holders of money orders had no claim against Rice. However, the trial court did not determine this issue. For what it is worth, the Texas Attorney General apparently assumed that Rice had an obligation to holders because it was indicated at oral argument that he directed Rice to make refunds to its customers. In any event, Judge Sneed concurs in the premise that no contract existed and that quantum meruit provides the basis for determining the amoung due to NWFX. Under the circumstances, it is difficult to discern an interest of NWFX in the proceeds that exceeds the interest of Rice. Rice's customers provided the money which was refunded to them and the refunds obliterated any claims by them against NWFX. In our view, creditors of NWFX had no greater interest in the Rice proceeds that the NWFX bankruptcy estate, whose limited interest is otherwise outlined in this opinion.

determine whether the proceeds were property of the estate, or alternatively, whether Rice owed a debt to the estate in the amount of $653,713.98. The bankruptcy court concluded that the proceeds were not property of the estate and thus negated a claim under 11 U.S.C. § 542(a). It also held that Rice had no contractual obligation to pay the funds to the estate. The district court affirmed. The Trustee now appeals.

A. MODIFICATION OF NOVEMBER 1984 AGREEMENT

[1] Both courts found that the parties did not mutually agree to modify, either orally or in writing, the terms of the November, 1984, agreement, to encompass the sale of noninsured money orders. This presented a question of contract formation. Whether or not a contract is formed in a particular instance is a question of law. *See Lemmers v. Hart Schaffner & Marx*, 701 F.Supp. 728, ____ (D.Neb.1987); *see also Neff v. World Publishing Co.*, 349 F.2d 235, 252-53 (8th Cir.1965).

There was some dispute as to whether an original contract encompassing noninsured money orders was ever prepared and presented by NWFX. Mr. Caldwell, an NWFX employee, testified that such had occurred and two employees for Rice testified to the contrary. Because the bankruptcy court was in the best position to observe the demeanor of the witnesses and to assess their credibility, we give great weight to its finding that Mr. Caldwell's testimony was not credible. *See In re Bush*, 696 F.2d 640, 643 (8th Cir.1983). The question before us is whether the bankruptcy court was correct in finding that the parties had not entered into an agreement for the sale of noninsured money orders. We agree with the district court that the bankruptcy judge's finding in this regard is well supported

by the evidence and we adopt the bankruptcy court's position on that issue.[2]

B. EQUITABLE INTEREST AS PROPERTY OF THE ESTATE

[2] On appeal, the Trustee also argues that it was error for the lower courts not to find that the estate had an equitable interest in the proceeds independent of any agreement of the parties. Initially, we note that the Trustee pursued recovery solely on the theory that subsequent negotiations and the conduct of the parties established that an agreement had in fact been reached whereby Rice would either hold the proceeds in trust, or as Northwest's agent.

[3] The overriding consideration in bankruptcy, however, is that equitable principles govern. *Matter of Tucson Yellow Cab*, 789 F.2d 701, 704 (9th Cir. 1986) (citing *Bank of Marin v. England*, 385 U.S. 99, 103, 87 S.Ct. 274, 277, 17 L.Ed.2d 197 (1966)). Equitable principles must be directed toward the care and preservation of the estate. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527, 104 S.Ct. 1188, 1196, 79 L.Ed.2d 482 (1984). Because we believe that the estate does have an equitable interest in some of the proceeds held by Rice, we now define that interest.

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[2]Because we agree that there was no subsequent modification or renegotiation of the November, 1984, contract, and since the November agreement aid not encompass proceeds from the money orders at issue here, we need not address whether or not the terms of such an agreement would have made Rice a trustee of the proceeds with Northwest as the beneficiary, or whether Rice was acting as Northwest's agent under such agreement. With regard to a trust, the court's finding of no agreement precludes finding a critical element of a trust—intent to establish a trust by the parties. *See Trustees of Graceland Cem. v. United States*, 515 F.2d 763, 775, 206 Ct.Cl. 609 (1975). Similarly, the court's ruling precludes finding acceptance by Rice of the authority to act as Northwest's agent for the sale of noninsured money orders. *See W. Seavey*, Agency § 18, at 32 (1964).

[4] In determining whether Northwest has an equitable interest in any of the money collected by Rice through issuance of Northwest's money orders, we look to state law to define the interest. 4 Collier ¶ 547.03, at 547-22. We will assume that the parties still intend Texas law to govern as they did when the November 1984, agreement was in effect.

In the absence of a contract governing the subject matter (here, the proceeds of uninsured money orders) a plaintiff may recover under the doctrine of quantum meruit where the plaintiff has (1) provided valuable services or materials; (2) the services and materials are accepted; and (3) the services and materials are accepted under such circumstances as to reasonably notify the recipient that the plaintiff intended to be paid. *See Corpus Christi v. S.S. Smith & Sons Masonry,* 736 S.W.2d 247, 248 (Tex.App.1987).

The theory of recovery is one of implied or quasi contract. It is based on a promise implied by law to pay for benefits rendered, knowingly accepted, and retained against the principles of equity and good conscience. *See Allen v. Berrey,* 645 S.W.2d 550, 553 (Tex.App.1982). The measure of recovery is, as indicated, referred to as quantum meriut, *see Knebel v. Capital Nat. Bk.,* 505 S.W.2d 628, 631-32 (Tex.Civ.App.), *aff'd in part,* 518 S.W.2d 795 (Tex.Sup.Ct. 1974), and is, in practice, reimbursement for unjust enrichment that stems from failure to make restitution of the benefits received under the circumstances. *Allen,* 645 S.W.2d at 553.

While we recognize that the money orders and the proceeds of their sale may be neither goods nor services, we believe that under Texas law, Northwest has an interest in at least some of the proceeds presently held by Rice. "A person who has been unjustly enriched at the expense of another is required to make restitution to the other." Restatement of Restitution § 1, at 12 (1937). At least one Texas court has adopted this Restatement section. *See Muller v. Nelson, Sherrod & Carter,* 563 S.W.2d 697, 701 (Tex.Civ.App. 1978).

Unjust enrichment occurs where there is a "failure to make restitution of *benefits* received under such circumstances as to give rise to [an] implied or quasi-contract to repay." *Allen*, 645 S.W.2d at 553 (emphasis added). Recovery is permitted in quantum meriut to prevent unjust enrichment. *Angroson, Inc. v. Independent Communications*, 711 S.W.2d 268, 273 (Tex.App.1986). The measure of recovery is reimbursement for unjust enrichment that stems from failure to make restitution of the benefits received under the circumstances. *Allen*, 645 S.W.2d at 553. Texas courts find a quasi-contract where a claimant has shown the right to recover in quantum meruit. *See id.* at 553.

We believe that there is unjust enrichment in allowing Rice to retain all monies held. Rice has profited. It knew that Northwest was supplying money orders with the intent of being paid, and in fact it did pay the face value and a fee to Northwest on the uninsured money orders for over a year.

We understand, as earlier indicated, that the money orders themselves may be neither materials nor services. We are not, however, addressing restitution based on the face value of the money orders. Rather, we are considering the benefits unjustly retained by Rice. Thus, we are confident that Texas courts would allow a claim in this case. *Cf. Goswami v. Metropolitan Sav. & Loan*, 751 S.W.2d 487, 491 (Tex.Sup.Ct.1988) (pleading that alleged payment of money may state a claim in quantum meruit); *Montes v. Naismith & Trevino Constr. Co.*, 459 S.W.2d 691, 692-94 (Tex.Civ.App.1970) (restitution ordered in the amount of the dollar value of materials supplied).

As other bankruptcy cases have indicated, *see Matter of Tucson Yellow Cab*, 789 F.2d 701, 704 (9th Cir. 1986), one permissible measure of reasonable value is the value that the parties established in their last valid agreement. Here, that would be the amount of the interest collected on

proceeds withheld beyond the date upon which the November agreement required remittance, plus the agreed upon fee of 11 cents per order.

On the issue of the refunded proceeds, however, no basis appears upon which such proceeds can be ordered turned over. Because Rice has refunded that amount, it cannot be said to be unjustly enriched. As to the proceeds not yet paid out, they should now be remitted to the estate except to the extent that Rice can clearly establish obligations to make further refunds during the life of the money orders. This is because retention in the absence of refunding unjustly enriches Rice, and because the estate apparently has claims against it from the holders of these unredeemed money orders.

CONCLUSION

The findings of the lower courts that the parties were not operating pursuant to a modified version of the November 1984, contract is affirmed.

Despite the absence of a legally valid agreement, however, there is an equitable interest equal to the reasonable value of the excess benefits Rice has received from its dealings with Northwest. These equitable interests constitute property of the estate. 11 U.S.C. § 541(a)(1). As NWFX property in Rice's possession, it is subject to turnover under 11 U.S.C. § 542(a).

Accordingly, the order appealed from is affirmed in part and reversed in part and this matter is remanded to the district court for further findings and orders consistent with this opinion.

SNEED, Circuit Judge, concurring in part and dissenting in part.

I concur in part and dissent in part with the majority opinion. My disagreement is with the manner in which the opinion measures Rice's unjust enrichment.

Judge Beam's opinion concludes that the unjust enrichment of Rice did not include refunded proceeds. I disagree. Rice has been unjustly enriched by all of the proceeds that it has received from the sale of the money orders. The record in this case does not suggest that Rice had an obligation to refund its customers. It was not a guarantor of the money orders it sold. Holders of Northwest's money orders have claims against Northwest, not Rice. Rice therefore should have turned over to Northwest all of the proceeds from its money order sales. Its decision not to do so kept its customers happy and maintained its good will at no cost to it. Northwest's creditors, other than Rice's customers, provided the funds by which Rice enhanced its reputation. Rice's customers have received payment in full on their claims against Northwest while all other creditors of Northwest will not.

It is doubtful that Texas law supports the position of the majority. Its method of measuring Rice's unjust enrichment stands in conflict with the authority the majority cites to support its finding that unjust enrichment has occurred. The Restatement of Restitution says that "[i]n an action of restitution in which the benefit received was money, the measure of recovery for this benefit is the amount of money received." Restatement of Restitution § 150 (1936); *see Holloway v. International Bankers Life Ins. Co.*, 354 S.W.2d 198, 213 (Tex.Civ.App.) *rev'd on other grounds*, 368 S.W.2d 567 (Tex. 1962) (citing the chapter of the Restatement that includes section 150). The majority holds that a party is unjustly enriched, not to the extent it has received money, but to the extent the money received has not been dissipated. I do not think that the Texas courts would uphold such a rule.

My result would not impose on Rice a double liability, one to its customers and another to Northwest. Although the issue is not before the court, Rice, after reimbursing its customers, could assert their claims against Northwest. Rice could argue either that the customers assigned to Rice their money orders claims or that Rice acquired the customer's claims under a theory of equitable subrogation. *See Smart v. Tower Land and Inv. Co.*, 597 S.W.2d 333, 337 (Tex.1980). To the extent that Rice would not receive full payment on these claims in the bankruptcy court at distribution, to that extent it would have paid for the maintenance of its goodwill. Moreover, it would have paid for it with its own money.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT
(Filed June 14, 1990)

No. 88-2395WA

In re: NWFX, Inc., (Consolidated)	*	
Debtor,	*	
Allen W. Bird, II, as Trustee for Northwest Financial Express, Inc., NWFX, Inc., and Gold Financial Express, Inc.,	*	Appeal from the United States District Court for the Western District of Arkansas
Appellee,	*	
vs.	*	
Crown Convenience, Derby Refining, et al., (Pyburn Enterprises, Inc.),	*	
Appellant.	*	

JUDGMENT

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is hereby ordered and adjudged that the judgment of the district court in this cause is affirmed

by an equally divided count in accordance with the opinion. The mandate shall issue forthwith.

June 11, 1990

A true copy.

ATTEST: /s/ Robert D. St. Vrain
CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT
MANDATE ISSUED: 6/12/90

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION
(Filed Aug. 1, 1988)
(Entered 8-5-88)

IN RE: NWFX, INC., No. FA 86-148 F

Debtor

ALLEN W. BIRD II, TRUSTEE FOR
NORTHWEST FINANCIAL EXPRESS, INC.,
NWFX, INC. and GOLD FINANCIAL
EXPRESS, INC. PLAINTIFF

v. No. AP 86-484

CROWN CONVENIENCE,
DERBY REFINING, ET AL. DEFENDANT

JUDGMENT

By order entered contemporaneously herewith, this court adopted *in toto* the proposed findings of fact and conclusions of law filed with this court on June 21, 1988, by the Honorable Robert F. Fussell, United States Bankruptcy Judge.

In accordance with the proposed findings of fact and conclusions of law, it is hereby ordered that the plaintiff, Allen W. Bird, II Trustee for Northwest Financial Express, Inc., et al., take and is hereby granted judgment against Pyburn Enterprises, Inc. (Pyburn) in the amount of $70,600.62. Further, the court finds the Trustee is entitled to recover prejudgment interest at the rate of 6% per annum from August 3, 1986, until April 26, 1988, on the amount of $89,0[illegible]2.28 and from April 27, 1988, until the date of this judgment on the amount of $70,600.62. Such judgment will

bear interest at the rate of 7.54% until paid as provided under 28 U.S.C. §1961.

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

cc: Allen W. Bird II, Trustee

11 U.S.C. § 105. Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

(c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.

11 U.S.C. § 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor; or

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement and that effects or gives an option to effect a forfeiture, modification, or

termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(2)

No. 90-441

FILED
OCT 5 1990
JOSEPH F. SPANIOL, JR.
CLERK

In the

Supreme Court of the United States

October Term, 1990

IN RE: NWFX, INC.
PYBURN ENTERPRISES, INC. ..... *Petitioner*

V.

ALLEN W. BIRD, II
AS TRUSTEE FOR NORTHWEST
FINANCIAL EXPRESS, INC., NWFX, INC.,
AND GOLD FINANCIAL
EXPRESS, INC. ..... *Respondents*

ON WRIT OF CERTIORARI FROM
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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No. 90-441

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SUMMARY OF ARGUMENT

The decision below affirmed a district court decision which reached the correct result, is fair to all the creditors of the debtor, NWFX, and preserves the principle of equality of distribution amongst creditors in bankruptcy. The Petition for Writ of Certiorari does not meet any of the enumerated circumstances in Rule 10 of the Rules of Supreme Court for the granting of Certiorari. Nor does the Petition set for any other special or important reason for the granting of Writ in this case.

ARGUMENT

I.

THERE IS NO CONFLICT BETWEEN THE TWO PRIOR DECISIONS OF THE EIGHT CIRCUIT COURT OF APPEALS THAT NEEDS TO BE RESOLVED.

There is no conflict between the two prior decisions of the Eighth Circuit Court of Appeals because the factual findings are different. Petitioner asserts that they present "similar circumstances" and that may well be true. However, the cases do have different facts which do account for the different results.

In the case of *In re NWFX, Inc.*, 864 F.2d 558, 590 (8th Cir. 1988) [hereinafter "NWFX I"] the bankruptcy and district court found and the Court of Appeals agreed that " . . . the bankruptcy court was correct in finding that the parties had not entered into an agreement for the sale of noninsured many orders." (A-43)

In the case of *In re NWFX, Inc.*, 864 F.2d 593, 594 (8th Cir. 1989) [hereinafter the "NWFX II"] the " . . . amounts were held in trust for the debtors pursuant to written trust agreements between the debtors and their agents." (A-33)

An agreement versus no agreement makes all the difference in the world and explains why one dealer was allowed to retain the money order proceeds and the other dealer was not.

NWFX I was decided on November 30, 1988. NWFX II was decided on January 5, 1989. The NWFX II panel had to know about the prior decision of the NWFX I panel and yet it did not mention the prior decision. That is because of the significant factual difference. That factual difference caused the issues that were argued and decided to be vastly different. Even a cursory review of the two decisions

reveals that the legal issues were markedly different. The difference in the legal issues flows from the presence versus the absence of an agreement between the debtors and the dealers.

In this case, there was a fact finding by the bankruptcy court and the district court that there was a Trust Agreement between the parties (A-23). Consequently those courts correctly followed the precedent of NWFX II.

This court has recently stated that it "... cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error." *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 107 S.Ct. 2617, 2623, 96 L.Ed.2d 572 (1987).

II.

THERE ARE NO IMPORTANT FEDERAL LAW QUESTIONS, UNANSWERED OR OTHERWISE, PRESENTED BY THIS CASE.

Petitioner set forth four "Questions Presented for Review" on page i of its Petition and asserts on page 8 that they are "... important and unsettled questions of federal law." The four questions simply do not present questions of federal law whether important, unsettled or otherwise.

The first question[1] is a choice of law question. Choice of law is a question of state law. In addition, the Petitioner did not plead in the bankruptcy court or the district court that Texas law should be applied. Neither did Petitioner argue

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[1]Is a contract between debtor, a seller of money orders, and its agent, governed by Texas law, where the agreement was executed and performed in Texas and where Texas had a substantial interest in protecting its citizens; or is it governed by Arkansas law, where the debtor is an Arkansas corporation and filed for bankruptcy protection in the state of Arkansas?

on appeal to the Eighth Circuit that Texas law should be applied until after the panel opinion was handed down.

The Eighth Circuit panel decision, which was vacated, recognized that neither party had asked for the application of Texas law when it said " . . . (t)he parties' repeated reference to Arkansas law in their briefs suggests that they assume that Arkansas law controls the interpretation of the NWFX-Pyburn agreement." (A-12) *In re NWFX, Inc.*, 881 F.2d 530, 535 (8th Cir. 1989).

The second question[2] is a breach of contract question. This second question is a question of state law. Indeed all four of the "Questions Presented for Review" are questions of state law. " . . . (S)tanding alone, a challenge to state law determinations by the court of appeals will rarely constitute an appropriate subject of this Court's review." *Haring v. Prosise*, 462 U.S. 306, 314 n. 8, 103 S.Ct. 2368, 2373 n. 8, 76 L.Ed.2d 595 (1983).

The third question[3] is an inaccurate statement of the issue that was tried and argued below. The Trustee's Complaint against the dealer was for breach of contract, not for turnover of property of the estate. Please note the last paragraph on page 3 of Petitioner's own "Statement of the Case", the first paragraph of the Proposed Findings of Fact and Conclusions of Law Regarding the Entitlement of Prejudgment Interest from Pyburn Enterprises, Inc. by bankruptcy judge Fussell (A-26) and the vacated panel decision which recognized that " . . . (t)he trustee sought damages for Pyburn's alleged breach of contract . . . " (A-6) *In re NWFX, Inc.*, 881 F.2d 530, 533 (8th Cir. 1989).

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[2]Did the debtor breach its agency contract when it became insolvent and filed a bankruptcy, resulting in the dishonor of its money orders nationwide?

[3]Were refunds made by the agent to purchasers of the debtor's dishonored money orders, property of the debtor's estate, and subject to turnover to the bankruptcy trustee?

The fourth question[4] is, on its face, a question of the assessment of pre-judgment interest when a breach of contract has been found. That is a question of damages and not of bankruptcy and is certainly not a federal question. This question was decided by two lower courts (the bankruptcy court and the district court), both of which deal on a daily basis with the question of pre-judgment interest. This court has previously said that " . . . federal judges who deal regularly with questions of state law in their respective districts and circuits are in a better position than we to determine how local courts would dispose of comparable issues." *Butner v. United States*, 440 U.S. 48, 58, 99 S.Ct. 914, 919, 59 L.Ed.2d 136 (1979).

III.

THE DECISION BELOW REACHED THE CORRECT DECISION ON THE LAW AND THE RESULT IS EQUITABLE.

The Petitioner entered into a written trust agreement with NWFX in which it agreed to hold all proceeds from the sale of money orders, after deducting a service charge, for the exclusive benefit of and to pay them over to NWFX. The Petitioner breached the trust agreement when, instead of paying the proceeds to NWFX, it paid the proceeds to Petitioner's customers.

If the Petitioner's defense is upheld, the effect will be that creditors of NWFX, who happened to be customers of Petitioner, would have their claims paid in full, while other creditors of NWFX, who are similarly situated, will not be paid in full and indeed will not even receive an equal pro rata share of the assets of NWFX. That is because the assets of NWFX would be diminished by the amounts retained by the Petitioner. Such an outcome violates " . . .

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[4]Should prejudgment interest be assessed against the debtor's agent as a matter of law when to do so would be inequitable?

the prime bankruptcy policy of equality of distribution among creditors of the debtor." H. Rept. No. 95-595, pp. 178, 95th Cong., 1st Sess. (1977).

IV.

THIS CASE DOES NOT PRESENT QUESTIONS THAT ARISE FREQUENTLY OR INVOLVE LARGE NUMBERS OF PEOPLE OR AMOUNTS OF MONEY.

This case arises from the bankruptcy of a corporation that sold money orders. None of the decisions below cited any controlling cases involving bankrupt money order sellers. There are very few bankruptcy cases reported that involve money order sellers in any way, shape, form or fashion.

The decision in this case will only decide the rights between the Petitioner and the Trustee of NWFX. While it is true that there are many other purchasers of money orders and creditors of NWFX whose dividend will be less if the Trustee losses, nevertheless, the amount of difference on an individual basis will be trivial.

The outcome of this case is not going to affect many people in the future because this kind of case does not happen very often. Even if it did, the only questions are questions of contract, damages and choice of law.

CONCLUSION

The decision below was correct on the law, reached an equitable result and does not leave the decisions of the Eighth Circuit in conflict. No special or important reason exists for granting the Petition because there is no conflict between the circuits, or decision of a state court of last resort or question of federal law.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Charles Wayne Baker, do hereby certify that a copy of the above and foregoing has been mailed by ordinary mail with sufficient postage affixed thereon, on this 4th day of October, 1990 to:

United States Court of Appeals
For the Eighth Circuit
U.S. Court & Customs House
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